Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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JUN 1 2 1996

In the Matter of	)	
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Allocation of Costs Associated with	)	CC Docket No. 96-112
Local Exchange Carrier Provision of	)	
Video Programming Services	)	

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NYNEX REPLY COMMENTS

The NYNEX Telephone Companies

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Date: June 12, 1996

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SUMMARY

The Commission should reject parties' proposals which would impose unreasonable if not outrageous cost burdens on LEC provision of video programming services through Open Video Systems or cable platforms, and other nonregulated activities. Instead, the Commission should move away from applying increasingly irrelevant Part 64 cost allocation rules in the price cap environment. In any case, the Commission should streamline those rules in a way that retains flexibility and use of cost-causative principles as new technologies and services are introduced. In this way, the Commission can preserve, not undercut, LECs' incentive to make video investments that will benefit telephone ratepayers and foster competition to entrenched cable firms.

With respect to shared network investment cost allocation, there is no reason to replace Part 64 with flawed, punitive allocation factors based on hypothetical networks or relative bandwidth. Some parties try to make much of the fact that, following direct assignment, the allocation of shared network investment costs has an inherent element of arbitrariness. Such parties seem to think this then gives them license to advance their own view of policy and propose any allocation factor, however onerous, to apply to LEC nonregulated activities. But their proposed allocation factors are especially arbitrary, unreasonable and stray from the use of cost-causative principles.

The opposition parties' proposals are also inflexible, and wrongly assume Part 64 is inadequate to accommodate emerging new nonregulated offerings like OVS. Even though OVS and other video nonregulated activities are not yet up and running, these parties assume they know how such services will utilize shared network plant. For example, they speculate that

significant embedded telephony plant is earmarked for such services, and such services will account for the "overwhelming" use of shared plant in the future. These parties are wrong. There is some uncertainty as to various carriers' operations. mix of nonregulated activities and exactly how some activities will use network facilities. Also, NYNEX believes that LEC competitive entry will necessitate investment in new plant for video, or, to a lesser extent, the reconfiguration of existing plant such that direct cost assignments can be made to nonregulated activities. As explained in the attached Declaration of Mr. Peter G. Haase, embedded telephone plant and spare facilities have not been placed for video; broadband facilities will likely be used for many new telephony services, and not just for video programming and nonregulated activities; and there is no basis in this proceeding for revising cost allocation rules so as to drive a greater proportion of embedded plant costs to nonregulated activities.

In these Reply Comments, after providing background placing the central issues in proper perspective, NYNEX will show the flaws in opposition parties' proposed allocation methods for shared network plant costs (Section III); respond to commentors' contentions on cost treatment of spare facilities (Section IV); and, last but not least, rebut parties' arguments for expanded exogenous treatment of cost reallocations from regulated to nonregulated activities (Section V). Concerning this exogenous issue, it bears emphasis that the FCC's rules provide no basis for exogenous cost adjustments for new joint network investment where nonregulated costs were not previously allocated to the regulated area.

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NYNEX REPLY COMMENTS

I. INTRODUCTION

The NYNEX Telephone Companies[1] ("NYNEX") file these Reply Comments to parties' comments submitted May 31, 1996, in the above-captioned matter. The Commission should reject parties' proposals which would impose unreasonable if not outrageous cost burdens on LEC provision of video programming services through Open Video Systems or cable platforms, and other nonregulated activities. Instead, the Commission should move away from applying increasingly irrelevant Part 64 cost allocation rules in the price cap environment. In any case, the Commission should streamline those rules in a way that retains flexibility and use of cost-causative principles as new technologies and services are introduced. In this way, the Commission can preserve, not undercut, LECs' incentive to make video investments that will benefit telephone ratepayers and foster competition to entrenched cable firms.

[1] New England Telephone and Telegraph Company and New York Telephone Company.

II. THE FCC SHOULD REJECT PARTIES' PROPOSALS THAT ARE UNNECESSARILY REGULATORY, RIGID, WITHOUT COST-CAUSATIVE BASIS AND DESTRUCTIVE TO PROCOMPETITIVE LEC INCENTIVES FOR VIDEO INVESTMENTS

Predictably, the entrenched cable operators in their comments seek to drive substantial cost burdens to competitive LEC video offerings such as OVS, even before those offerings exist.[2] Those cable operators thereby hope to stifle or delay competitive entry by LECs, who will be starting with zero market penetration. This would be contrary to Congress' intent to stimulate LEC video competition with those cable firms and contrary to FCC procompetitive policies,[3] and result in disparate treatment of LECs and cable firms.[4] For their part, interexchange carriers seek to drive significant costs away from regulated activities in an attempt to drive down price cap indices and interstate access rates.[5] As discussed herein, these parties offer extreme, unreasonable and arbitrary cost allocation proposals. If such approaches are adopted, and elements of LEC rate of return regulation continue, LECs would be seriously discouraged from offering OVS or other nonregulated activities on an integrated basis. This result would harm telephone ratepayers, who would be denied benefits from the economies of scope of an integrated network, and from nonregulated activities' contribution to the regulated area in excess of costs caused by nonregulated activities. Also, the full panoply of video competition envisioned by

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2 E.g., Continental Cablevision, Cox Communications, NCTA, Time Warner.

3 See, e.g., Docket 96-112 NPRM released May 10, 1996, ¶ 22.

4 As Sprint points out (p. 6), the FCC's Cable Cost Allocation Order decided to "allow for [cable] operator flexibility in determining specific allocators and allocator schemes." MM Docket No. 93-215, CS Docket No. 94-28, FCC 95-502, released January 26, 1996, ¶ 119. Yet the cable operators would negate flexibility for LECs.

5 E.g., AT&T, MCI.

Congress would not be realized, and a regulatory failure reminiscent of video dialtone could recur.

The FCC should cut through all the opposition parties' cost allocation proposals, and give emphasis to the fact that the FCC's price cap regime has essentially severed any direct or close link between regulated interstate costs and rates.[6] In that environment, the Part 64 cost allocation rules have become much less relevant, and any residual relevance may soon disappear entirely. To the extent possible, the Commission should move towards elimination of Part 64. The Commission should consider forbearing from applying Part 64 to LECs (such as NYNEX) which will be subject to price cap regulation without any sharing/low-end adjustments. At a minimum, the Commission should waive Part 64 in such cases and simplify and streamline Part 64 rules in this proceeding.[7]

With respect to shared network investment cost allocation, there is no reason to replace Part 64 with flawed, punitive allocation factors based on hypothetical networks[8] or relative bandwidth.[9] (See Section III, infra.) Some parties try to make much of the fact that, following

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6 NYNEX 5-6. The FCC has recognized that its price cap regime is its primary means of guarding against any cross-subsidy leading to unreasonably high telephone rates. See, e.g., Video Dialtone Reconsideration Order, CC Docket No. 87-266, 10 FCC Rcd 244, ¶ 166 (1994).

7 AT&T contends that Part 64 should be retained for price cap LECs because it is needed to monitor the reasonableness of telephone rates. AT&T 11-12; See also Cox, MCI. However, the link between telephone rates and costs is tenuous at best, and Part 64 was never intended to be a basis for investigating prices. See Joint Cost Order, CC Docket No. 86-111, 2 FCC Rcd 1298, ¶¶ 33, 40 (1986). MCI adds that Part 64 is needed since price cap LECs will be subject to exogenous cost adjustments. MCI 16-17 But the Commission is moving towards a price cap productivity factor that will obviate many exogenous adjustments. See NYNEX 22-23.

8 See AT&T, MCI, NCTA.

9 See Continental Cablevision.

direct assignment, the allocation of shared network investment costs has an inherent element of arbitrariness.[10] Such parties seem to think this then gives them license to advance their own view of policy and propose any allocation factor, however onerous, to apply to LEC nonregulated activities. But their proposed allocation factors are especially arbitrary, unreasonable and stray from the use of cost-causative principles.

The opposition parties' proposals are also inflexible, and wrongly assume Part 64 is inadequate to accommodate emerging new nonregulated offerings like OVS.[11] Even though OVS and other video nonregulated activities are not yet up and running, these parties assume they know how such services will utilize shared network plant. For example, they speculate that significant embedded telephony plant is earmarked for such services, and such services will account for the "overwhelming" use of shared plant in the future.[12] These parties are wrong. There is some uncertainty as to various carriers' future operations, mix of nonregulated activities and exactly how some activities will use network facilities.[13] Also, NYNEX believes that LEC

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[10] E.g., NCTA.

[11] E.g., CCTA, NCTA. While in some respects the Part 64 rules are too complex, cumbersome and skewed towards the telephone ratepayer, those rules have been operating effectively for almost a decade. See also GSA 8. Further, as pointed out by Sprint (p. 3), the FCC has recognized that: "the Joint Cost rules set forth in Part 64 were formulated to accommodate new enhanced services offerings in an increasingly competitive telecommunications environment. Part 64, for the most part, does not prescribe cost categories or allocation factors.... The Commission chose this approach because it believed that the mix of nonregulated activities and the organizational structure would vary widely from carrier to carrier, and that a single, prescribed manual could not adequately encompass the possible variations." Video Dialtone Reconsideration Order, supra, ¶ 180. With respect to video dialtone-related nonregulated activities, the Commission adhered to its long-standing approach "to avoid product-specific cost allocations to nonregulated products and services." Id.

[12] E.g., Continental Cablevision.

[13] See NY DPS, Pennsylvania OCA.

competitive entry will necessitate investment in new plant for video, or, to a lesser extent, the reconfiguration of existing plant such that direct cost assignments can be made to nonregulated activities. As explained in the attached Declaration of Mr. Peter G. Haase, embedded telephone plant and spare facilities have not been placed for video; broadband facilities will likely be used for many new telephony services, and not just for video programming and nonregulated activities; and there is no basis in this proceeding for revising cost allocation rules so as to drive a greater proportion of embedded plant costs to nonregulated activities.

With this background placing the central issues in proper perspective, NYNEX will show the flaws in opposition parties' proposed allocation methods for shared network plant costs (Section III); respond to commentors' contentions on cost treatment of spare facilities (Section IV); and rebut parties' arguments for expanded exogenous treatment of cost reallocations from regulated to nonregulated activities (Section V).

III. PARTIES OFFER FLAWED APPROACHES TO ALLOCATING SHARED NETWORK PLANT COSTS

NCTA recommends a fixed factor approach such that 25% of common costs will be allocated to regulated telephony and 75% will be allocated to video transmission. After stating that cost allocation is inherently arbitrary, NCTA seeks to justify its proposal on the basis of "proxy cost models" and "policy goals" to protect the telephone ratepayer.[14] NCTA additionally asserts that its approach is administratively simple, adapts to evolving technologies, permits uniform application among incumbent LECs, and is consistent to the extent possible with principles of cost causation.[15]

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[14] See NCTA i, 10-12, 15. See also Cox, Comcast, GSA, Time Warner.

[15] NCTA i.

Compared to NYNEX's proposals, such recommended fixed factor approaches as urged by NCTA are exceedingly arbitrary, unreasonable and inimical to LEC procompetitive incentives for video investments.[16] NCTA's recommendation has no basis in reality, since carriers (including NYNEX) will likely vary significantly in how they provision video products and other nonregulated activities, as well as how they provision telephony and other services using broadband facilities.[17] Carriers will utilize different types of technologies and platforms, and offer different service features in the rapidly moving competitive environment. The Commission should therefore reject such specific, inflexible rules as put forth by NCTA/entrenched cable operators.[18]

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16 Cox in supporting a 25%/75% proposal (similar to NCTA's) tries to justify a change in Cox's position from the video dialtone context where Cox proposed 50%/50% allocation between telephony and video. Cox states that the 50%/50% proposal was to apply before Part 64, and now that OVS is to be nonregulated (compared to regulated video dialtone), a greater (75%) allocation to video is warranted to prevent cross-subsidy. See Cox n. 7, n. 12. Cox's proposed distinction is bogus. Part 64 applies before Part 36 and Part 69, and entirely removes fully distributed costs of nonregulated activities from regulated revenue requirements. Cox's instant 75% proposal drives more costs to video, and is more onerous and unreasonable than the 50% proposal.

17 The NY DPS states (pp. 1, 3-4): "Because competition in the local exchange is only in its incipient stages, particularly with respect to video services, there remains much uncertainty as to the impact, extent, and timing of the emerging competition.... [T]here is no meaningful basis on which to estimate the extent to which LECs may use existing loop facilities to jointly provide regulated and nonregulated services." See also Pennsylvania OCA 8 ("integrated broadband architectures are likely to be complex and will vary from location to location.")

18 Furthermore, NCTA (pp. 10-11) analogizes the use of a fixed factor to the general allocator under Part 64. This analogy ignores the fact that the general allocator is applied to only about 10.5% of the NYNEX Telephone Companies' total expenses (and 4.5% of total costs) and only after cost-causative means have been exhausted, whereas the factor proposed by NCTA would be applied to a much greater proportion of a LEC's total costs.

While fixed factors as proposed by NCTA and others are obviously simple and uniform, they lack any reasonable basis in fact and experience. unlike Bell Atlantic's proposal (at pp. 9-10).[19] As NYNEX has shown (pp. 14-16). where significant and stable data and experience are gathered reflecting how services use common facilities such as broadband, a fixed factor may be appropriate.[20]

The FCC should thus maintain flexible cost-causative approaches, and reject imposition of fixed factors having no basis in reality and no relation to cost-causative principles. As shown in our initial Comments, the Commission should continue to allow for direct assignment of costs based upon cost causation to the maximum extent possible:[21] and for other costs to be attributed

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[19] Time Warner asserts (pp. 8-10) that its 25%/75% proposal (similar to NCTA's) is supported by "available facts" and "available data," but none are provided.

[20] NCTA also states (p. 12) that its proposal is appropriate to protect consumers who will be "vulnerable to telephone rate increases resulting from LEC cross-subsidization of integrated networks to provide video services." In fact, for the NYNEX Telephone Companies, consumers have received rate decreases totaling approximately $330 million in both the federal and state jurisdictions since 1993 (cumulatively, this amount would be much greater). With price caps in the federal jurisdiction, incentive plans in most of its states, and intensifying competition, NYNEX's ability to raise prices is severely constrained. Thus, NCTA's assertions that ratepayers will suffer from increased telephone rates due to misallocation of investment costs or the existence of spare fiber capacity, are totally without merit. NCTA further attempts to justify its fixed factor approach based on universal service. NCTA 12. The purpose of the Commission's Part 64 rules is to rationally and fairly allocate joint and common costs between regulated and nonregulated activities. See Joint Cost Order, ¶¶ 33, 37, 40, 109. Part 64 was never intended to be a universal service support mechanism. As stated by the Commission, "we would not think it proper to attempt through cost allocation rules to arrange a subsidy for regulated activities." Id. at ¶ 109.

[21] MCI claims (p. 5) that unless the Commission modifies Part 32 accounts, or reinstates its video dialtone tracking requirements, it will not be possible to directly assign most video costs. MCI is incorrect. Part 64 requires direct assignment whenever possible. See 47 C.F.R. Section 64.901(b)(2). If companies were capable of tracking certain costs for direct assignment under video dialtone, the codes would still be available to use to directly assign the appropriate costs under a Part 64 cost apportionment. The difference is now Part 32 subsidiary records are not required as the tracking mechanism. The primary difference between cost allocations currently required and those under the video dialtone regime is that,

based upon an allocator logically related to cost causation whenever possible; and for remaining costs to be allocated in proportion to preceding cost attributions.[22]

AT&T proposes that shared loop and switching costs be allocated using fixed factors based upon Total Service Long Run Incremental Cost ("TSLRIC") studies establishing a cost relationship between regulated and nonregulated activities. AT&T recommends that this approach be implemented three months from the effective date of the FCC's Order in this proceeding.[23] AT&T suggest that TSLRIC studies should be performed pursuant to such a model as the Hatfield Model proposed by AT&T in its Comments in the Docket 96-98 Interconnection proceeding.[24]

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in the latter, regulated video was separated from regulated telephony, whereas under Part 64 video will be included with other nonregulated activities which are separated from regulated activities.

[22] With respect to shared loop plant under an architecture utilizing separate drops for video and telephone, the Commission should permit direct assignment of drop costs, and attribution of shared costs in proportion to directly assigned amounts. This comes as close as possible to a cost-causative apportionment. Under a switched digital video ("SDV") architecture, in which a common video/telephony drop could be employed, the Commission should permit shared costs to be allocated in proportion to the relative number of video and telephony service connections (i.e., a "virtual loop" methodology). Thus, the shared costs are proportionately assigned to the customers who are actually using the loops and in that sense "causing" the costs to be incurred. The flexibility to utilize such cost-causative techniques reasonable to the particular technology/architecture must be maintained in favor of arbitrary, baseless fixed factors or other "one-size-fits-all" approaches.

[23] AT&T 4-7.

[24] AT&T n. 8. In a similar vein, MCI urges that cost allocations between regulated and nonregulated activities be based on stand-alone cost ceiling estimates utilizing the Hatfield Model. MCI 6-9. MCI alternatively suggests a fixed factor approach that is supposedly consistent with cost causation principles, but MCI does not explain that consistency. MCI 8. Its proposal is no less flawed than other fixed factor proposals (such as NCTA's), and should be rejected.

AT&T's and MCI's proposed approaches based on TSLRIC are severely flawed,[25] overly complicated[26] and must be rejected. The Hatfield Model based on TSLRIC is merely a computer model purporting to develop a hypothetical "blank slate" network (a network built from the ground up using the latest available technology). The Hatfield Model departs from economic reality and produces meaningless results. As MCI has admitted, the Model produces costs that are only 44% of the LECs' existing revenue requirements.[27] The Model uses a fictional network architecture in place of the LECs' actual networks. The proponents of the Hatfield Model believe they can design a "more efficient" nationwide telephone network on a personal computer using a handful of parameters, such as distance, population density and soil conditions. This does not begin to represent all of the factors that a LEC must take into account in building a network that will meet the needs of its customers.[28]

Accordingly, the Hatfield Model/TSLRIC approach provides no meaningful information about the LECs' network costs, and how regulated and nonregulated activities will utilize

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[25] See NYNEX Reply Comments filed May 30, 1996 in CC Docket No. 96-98, pp. 19-29.

[26] In this respect, their approaches go against the deregulatory intent of the Telecommunications Act of 1996. AT&T's methodology would have LECs perform three separate cost studies (which are likely to be contentious), which may be based on actual or assumed costs (a LEC would not actually have "telephony-capable loop plant that already provides video"). See AT&T 5. AT&T would have this factor developed within three months of an Order in this proceeding regardless of whether or not companies have any actual investment or have made a commitment to a particular type of architecture or supplier, which factors would affect the outcome of any study which would take reality into account.

[27] MCI Comments filed May 16, 1996 in CC Docket No. 96-98, pp. 73-74.

[28] The Model assumes without basis that the LECs are wildly inefficient, and that they could return to profitability by eliminating unnecessary costs. The Model's proponents do not explain how NYNEX, or any other LEC, could achieve the massive cost reductions that would be necessary to make a profit at the rate levels in the Model, nor explain how quality service could be provided at those levels.

network plant. That approach, unlike NYNEX's proposals, does not reflect cost-causative principles relating to actual plant and costs, and must be discarded.[29]

Continental Cablevision asserts that shared network plant should be allocated "overwhelmingly" towards LEC video, i.e., allocated based on relative bandwidth (over 95% to video). According to Continental Cablevision, such allocation is appropriate because it reflects relative occupancy and usage,[30] and new LEC broadband facilities are being constructed principally for video.

Continental Cablevision's position is without merit. As shown in the attached Declaration, NYNEX will construct new broadband facilities to accommodate an array of telephony and nonregulated offerings, of which OVS may be only one, unless regulatory requirements are so onerous as to disincent such integrated video offerings. In addition, Continental Cablevision's proposed bandwidth allocation is not supported by principles of cost causation or actual use. With respect to a service architecture involving separate drops for video and telephony, NYNEX has explained how a direct assignment-based cost apportionment methodology is reasonable and reflects cost causation. Regarding a service architecture involving common video/telephony drops, NYNEX will provide an electrical path for each service connection, whether for video or telephony. In that instance, an allocation based on

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[29] AT&T suggests that in the interim before adoption of a TSLRIC approach, the Commission should require 50%/50% allocation. AT&T states without justification that such approach would be "reasonable." AT&T 7; see also NY DPS 3. With respect to a 50%/50% allocation for common costs, Continental Cablevision states (pp. 6-7): "While superficially appealing, the FCC should reject this suggestion as it is not based on any reasoned principle .... If the FCC is to adopt a rational approach, it must ground its decision in some relative measure that is based upon real usage."

[30] Continental Cablevision 2-3.

relative number of service connections is reasonable and reflects cost causation. By contrast, relative bandwidth is simply not relevant, since all circuits are derived electronically by equipment at the end of each facility.

Finally, by loading a clearly unreasonable and punitive cost burden on video -- a regulatory full nelson -- Continental Cablevision's proposal would deter any LEC integrated telephony/video offerings, and thus deny consumer benefits.

IV. PARTIES DO NOT JUSTIFY SPECIAL ALLOCATION RULES FOR SPARE FACILITIES

Several commenting parties assert that LEC spare facilities are or will be predominantly for video, and the costs of those facilities should be allocated predominantly if not entirely to nonregulated activities.[31] These parties provide no factual basis for their position, and they are wrong. As explained in NYNEX's initial Comments (pp. 3, 18-20, 24), and further substantiated in our attached Declaration: the Commission's Part 64 rules already adequately apportion spare facilities based upon cost-causative principles;[32] embedded spare facilities are for telephony;[33] and spare fiber to be installed will be used by various broadband services including telephony, and not only video.

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[31] See Cox, Continental Cablevision, Time Warner. MCI's proposed Hatfield Model would essentially define away spare facilities as unnecessary and inefficient. See MCI 15. Not only is that Model grievously flawed, as discussed, but MCI ignores the legitimate need to engineer telecommunications networks with additional capacity to handle peak demand and growth. (See attached Declaration of Mr. Peter G. Haase.) Indeed, the Commission has noted that AT&T's competitors (including MCI) have enough "excess capacity" to handle two-thirds of AT&T's traffic within 12 months. See Policy And Rules Concerning The Interstate, Interexchange Marketplace, CC Docket No. 96-61, Notice of Proposed Rulemaking, March 25, 1996, p. 30 n. 121.

[32] GSA (p. 6) and NCTA (pp. 21-22) at least agree that spare facilities should be directly assigned whenever possible. However, NCTA goes on to state that telephone companies must be required to "conclusively show" that spare facilities will be used for telephony, or else the costs will be allocated to nonregulated activities. NCTA 22. NCTA's proposed standard is arbitrarily one-sided, and thus should not be adopted.

V. COMMENTORS PROVIDE NO BASIS FOR EXPANDING THE TYPES OF COST REALLOCATIONS FROM REGULATED TO NONREGULATED ACTIVITIES SUBJECT TO EXOGENOUS TREATMENT UNDER PRICE CAP RULES

Several parties propose that any cost reallocations from regulated to nonregulated activities that arise from changes in the Part 64 process should be given exogenous treatment under LEC price cap regulation, so as to drive down price cap indices and interstate access rates.[34] As we demonstrated in initial Comments (pp. 21-24), such expansion of exogenous treatment is entirely unwarranted, since: it would likely create a double-count under the price cap formula; be inconsistent with FCC standards denying exogenous treatment for accounting rule changes not impacting discounted cash flow; and severely thwart LECs' incentive to engage in integrated nonregulated activities that would otherwise benefit the telephone ratepayers.

The parties supporting such expanded exogenous treatment provide no justification to overcome these points. AT&T quotes from FCC rules and paraphrases FCC Orders in a way that characterizes the Commission's existing Rule 61.45(d)(1)(v) as requiring exogenous treatment for <u>all</u> reallocations of costs from regulated to nonregulated activities.[35] AT&T is wrong. FCC Rule 61.45(d)(1)(v), as explained in the <u>LEC Price Cap Order</u>[36] cited by AT&T, is narrow in

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[33] Time Warner asserts (p. 11) that broadband (<u>i.e.</u>, fiber) facilities at the local loop level are totally unnecessary to the provision of regulated telephone service and that such facilities are constructed solely to enable the telephone companies to provide nonregulated services. Time Warner is mistaken. Mr. David Fellows in support of Continental Cablevision's Comments enumerates the operational advantages of deploying fiber -- minimizing signal loss, enhancing reliability, etc. The same holds true for transmission of telephony signals.

[34] <u>See</u> AT&T, Comcast, MCI, NCTA.

[35] <u>See</u> AT&T 10-11.

[36] CC Docket No. 87-313, 5 FCC Rcd 6786, ¶¶ 171-72 (1990). There the Commission indicated that the required exogenous cost adjustment relates to "required reallocations" pursuant to the Rule 64.901 provision whereby "carriers ... allocate common plant investment

scope. That rule only applies to the situation where, pursuant to Rule 64.901(b)(4), joint network plant is allocated using the forward-looking peak nonregulated usage allocator; actual reported nonregulated usage (Form 495B) turns out to exceed the projected forward-looking peak usage (Form 495A); and the carrier makes the required reallocation of network investment from regulated to nonregulated activities.[37]

MCI (at p. 16) recognizes the narrow scope of Rule 61.45(d)(1)(v), and asks for expansion but provides absolutely no basis for such expansion. A few other parties merely state that expanded exogenous treatment is warranted to compensate and benefit ratepayers for nonregulated use of facilities "paid for"[38] by those ratepayers.[39] These parties' position is baseless. As discussed earlier, embedded telephone plant is not equipped for new video programming service offerings; and artificial reallocation of such plant costs would penalize and deter LEC procompetitive efforts.

Finally, it is important to emphasize that under the price cap rules, exogenous cost treatment in this context relates only to when regulated costs are removed and "reallocated" to nonregulated activities based on the forward-looking usage allocator process referenced above. The exogenous cost provisions do not, and cannot apply to the deployment of new network

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between regulated and nonregulated activities in accordance with a three-year forecast of relative regulated and nonregulated use."

[37] See NYNEX 22 & notes 50-51. Companies have amended their Part 64 Cost Allocation Manuals ("CAMs") for new nonregulated services and cost pool changes on a regular basis. Contrary to AT&T's suggestion, no such cost allocations have required exogenous adjustment. Long run productivity will increase where a company provides new services over an integrated network, realizing efficiencies in both the regulated and nonregulated areas.

[38] See Comcast 8-9.

[39] See NCTA 23-24.

investment to provide both regulated and nonregulated services, where nonregulated costs were not previously allocated to the regulated business.

VI. CONCLUSION

The Commission should reject commentors' proposals that are counter to the deregulatory, procompetitive intent of the Act to encourage LEC video offerings providing a viable alternative to entrenched cable providers.

Respectfully submitted,

New England Telephone and
Telegraph Company

New York Telephone Company

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DECLARATION OF PETER G. HAASE

I, Peter G. Haase, declare the following:

1. I am Managing Director - Broadband Initiatives for NYNEX. My responsibilities include the planning, project management and implementation of the NYNEX broadband network. As part of my responsibilities, I am familiar with the economic factors affecting technology selection, impact of cost allocations on business viability and variations in these factors under changing environments and assumptions.

2. The purpose of my Declaration is to discuss NYNEX's current network, plans for a switched digital broadband network, and the impact of cost allocations.

3. NYNEX's current network has been built to support the existing telephony services. Since the late 1970's NYNEX has deployed fiber in its interoffice network because it is more cost effective (on a life-cycle basis) than any other available technology. Similarly, feeder routes requiring additional capacity have been augmented

by utilizing fiber. Any spare capacity is therefore primarily in the interoffice and feeder routes -- placed in accordance with engineering design guidelines.*

4. As with all capacity constrained infrastructure (sewer, highway, power lines, etc.), telephone networks are built to carry peak loads as well as to care for future demands. It is more cost effective to provide for some reasonable spare capacity during the original construction than to return to add capacity at frequent intervals. The expected exhaust of a network component or facility is expressed in terms of time. Network components will have different exhaust times primarily as a function of the cost and difficulty of providing additional capacity The spare fiber capacity in NYNEX's existing network has been engineered and built based on these principles for the regulated telephone services.

5. While NYNEX is continuously reevaluating available architecture and technology alternatives, the present approach to a broadband network build is to utilize a Switched Digital Video (SDV) loop architecture that is capable of providing both traditional telephony and high bandwidth video services. The existing loop network (copper) is not capable of supporting the increased bandwidth requirements and does not provide the increased maintenance efficiency of fiber-based systems. These SDV loop systems therefore provide the dual benefits for both the regulated (telephony) and unregulated (including video) services.

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* Engineering cost studies indicate that less than 9% of total cost to build an integrated broadband network is directly attributable to the cost of installed fiber. Therefore even if existing spare fiber capacity were to be utilized for the broadband network, the savings would be diminimus.

6. Several variables play a significant role in how the investment needed to build a broadband network is allocated, i.e., direct investment to regulated services (telephony, data) or to unregulated services (video and a host of new multimedia and other services yet to be defined). Some of the most significant factors which affect how capital is distributed are: 1) the type of technology employed; 2) how the broadband network is built; 3) which vendors have been contracted to supply the network components; and, 4) the actual market penetration of any nonregulated service. Among the approaches to video cost allocation, NYNEX believes that a methodology reflecting actual usage, either through direct investment or services provided, is reasonable and equitable. The FCC should permit flexibility of carriers to utilize cost allocation approaches appropriate to their specific facilities and services.

7. While a mandated fixed factor approach toward video cost allocation may provide an easily managed process, it neglects the variables that actually produce the allocated costs associated with a broadband network, most significantly the relationship between direct video costs and market penetration. A fixed factor set too high places new entrants into the market at a great disadvantage and would discourage competition. Additionally, since the technology employed, deployment strategy, component costs and competition within different market areas are never the same, an allocation method of this type would ultimately hinder some carriers and benefit others, and therefore disadvantage subscribers.

8. On the other hand, a cost allocation methodology based on direct investment ratios or service connections (as proposed by NYNEX), would serve the industry more equitably and offer a greater incentive to build full service networks.

Using either of these methods, direct and common video costs increase as the broadband network build-out progresses (estimated to be on the order of 20%-30% at the end of the build), representing a more balanced approach for the industry as a whole.

I declare under penalty of perjury that the foregoing is true and correct.

Executed on June 7, 1996

P.G. Haase

Peter G. Haase

CERTIFICATE OF SERVICE

I, Yvonne Kuchler, hereby certify that copies of the foregoing <u>REPLY COMMENTS</u> were served on the parties listed on the attached service list, this 12th day of June, 1996, by first class United States mail, postage prepaid

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